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Safety Nets in Transition Economies: A Primer

Louise Fox

March 2003

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Social Protection
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Social Safety Net Primer Series

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Abstract

This paper focuses on the experience of the transition countries of Central and Eastern Europe and Central Asia in providing adequate safety nets for the poor during the last 10 years. The paper discusses the problem of poverty and vulnerability – who were the poor, and how did the answer to this question change over the decade, it looks at the typical types of interventions offered by governments, and how this package changed over the period. It surveys the evidence on effectiveness of these programs in reaching the poor, in reducing their income poverty, or reducing other aspects of poverty (e.g. social exclusion). The results are quite striking, as in all countries, classic targeted safety net policies played a small role in reducing poverty. In part, this was because of the uniqueness of the period – conventional good practice was not always applicable.

Recently, several countries in the region have improved the coverage and targeting of their programs, offer good models for other countries. If all middle income countries in the region adopted these models, including insuring adequate financing, effective poverty reduction at low cost is possible. Financing for this benefit could come from reducing expenditures on untargeted categorical benefits and energy subsidies. Low income countries may find that implementing a full means-tested cash benefit system is too costly and administratively complex, although it should be noted that Armenia and Albania have both implemented programs successfully. These countries may wish to try less complex solutions such as distributing food rations through schools or school feeding programs. Fee waivers or subsidies to improve access to social services for the poor could also be helpful.

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Introduction

In their purest form, "transition economies" are a unique feature of the last decade of the twentieth century. The term most commonly applies to the countries of the former Soviet Union and those of Eastern and Central Europe that were in the so-called "Soviet block,"[1] and relates to the changes in economic and social structure that were released by the fall of the Berlin wall in the summer of 1989 and the subsequent break-up of the Soviet Union in 1991-92. The transitions are usually considered to be of two types:

- The transition from a fully planned economy, with primarily state ownership of production, to a market economy, with primarily private ownership of assets and market-supporting economic institutions.
- The transition from a single-party state linked in significant economic and political (security) relationships with the Soviet Union, to a state with more open and global trade relations and another political system. In most of the European transition countries, this transition is explicitly intended to be toward a pluralistic democracy, leading to close linkages with Western Europe (including accession to the European Union for at least 10 countries), while in other countries, the end point is not as clear.

In a broader sense, the universe of transition economies is wider. A number of countries in Asia and Africa have also been engaged in one or both of these transitions. China and Viet Nam, for example, began the move toward a more open economy and more private ownership even earlier, while Mongolia began its own transition at the same time as the CECA countries. Several countries in East Africa, for example, are making similar economic transitions toward more private ownership and a more open trading and pricing regime. These countries are generally not considered in the same group as the transition countries of CECA. However, they have faced some of the same problems. Indeed after a decade of economic decline (often exacerbated by armed conflict), some of the lowest-income transition economies of CECA may have more in common with low-income developing countries than with their more well-to-do neighbors.

[1] A number of terms have been coined to describe this large, heterogeneous group of countries, linked primarily through their political alliance with the Soviet Union. Throughout this paper we will refer to these countries as the Central and Eastern European and Central Asian countries (CECA countries).

Several aspects of the transition in the CECA countries are exceptional, however, and set these countries apart. First, all countries experienced a common shock—the collapse of trading relationships, which administered a major shock to their economies. The reasons this shock was so difficult in these countries (especially those from the former Soviet Union) are the speed of change, which was unexpectedly fast with highly negative consequences; and the high level of industrialization based on economic specialization by country compared with other developing countries undertaking transitions to a more market-oriented system. In CECA countries (compared with China and Viet Nam, for example), there was little that improved performance in the agricultural sector could do to cushion the shock, and little surplus to take from agriculture to finance the needed investment in the new economy. Considered in this light, the transition economies of CECA are indeed distinctive, and their experience of the last ten years was a unique one in economic and social history.

Second, although the countries are ethnically quite different, all began the transition with similar institutions, modeled for the most part on Soviet practice. These included high levels of urbanization (often accelerated through the creation of company towns in the periods of most intensive industrialization) with an associated large wage economy, which was the basis for a broad social insurance program; and a large social service infrastructure with a common approach to social service delivery including the provision of social welfare services. This implied that they started the transition with above-average social indicators given their incomes, including high levels of education, low levels of inequality, and high expectations regarding the government's role in reducing risk. These initial conditions put these countries in a group of their own compared with the rest of the middle- and low-income developing world.

This paper focuses on the experience of the countries of CECA in providing adequate safety nets[2] for the poor during the transition period. It is for the most part a stock-taking, as throughout the last decade both the scope of the problem as well as policy and programmatic responses have been evolving quickly. We begin by reviewing (briefly) the economic history of the transition—output decline and recovery. We then turn to discussing the problem of poverty and vulnerability—who were the poor, and how did the answer to this question change over the decade? Following what has now become the convention (World Bank 2000b, 2002b) in analyzing transition economies, we divide the countries into the higher-income European pre-accession countries and remaining the lower-income countries of the CIS and Southern Europe. Next we look at the typical types of interventions offered by governments, and how this package changed over the period. We then survey the evidence on

2 The term "safety nets" has multiple meanings. In a recent paper, Beasley, et al. defined it as "public interventions which are designed to serve two key functions: (i) to play a redistributive role transferring resources towards the poorer members of society to bring them out of poverty, (ii) to provide greater opportunities for individuals to mitigate risks from unforeseen contingencies." (p. 4, 2001). This definition includes both social assistance and social insurance, as well as a range of social services. In this paper, we choose a more narrow focus. We exclude social insurance for the most part, as this topic already has a broad literature, and focus instead on transfers to households from governments which do not have an insurance character but are meant to provide or substitute for income—cash transfers, food stamps, food-related programs where the implicit income transfer is important, labor-intensive public works done to provide self-targeted transfers through wages, and so on. Mechanisms to provide fee waivers, vouchers, or scholarships for services deemed essential but for which charges usually apply will be included—scholarships for school, mechanisms to waive fees for health care services, or for heating in cold climates. We exclude most social services, but we include social care services since in CECA countries these are often a (poor) substitute for transfers to households.

effectiveness of the safety net programs in reaching the poor, reducing their income poverty, or reducing other aspects of poverty (e.g., social exclusion). The results are quite striking, as in all countries, classic targeted safety net policies played a smaller role than expected in reducing poverty. In part, this was because of the uniqueness of the period—targeting was not easy. We conclude with some lessons from this experience, which may be helpful for the countries still struggling with the transition, as well as for other countries, including those still hoping to make a transition.

Economic Performance during the Transition, the Plight of Households, and the Policy Response

Economic performance during the first 10 years of the transition was characterized by two main events[3]:

- An output shock, caused primarily by disruption in trade and financial links, and falling terms of trade, but also by regional conflicts and declining world demand. This output shock was usually accompanied by a bout of inflation resulting from the financial repression preceding the transition.
- An eventual recovery, led by private sector growth, especially in the service sector (which had been repressed during the planned economy period), and a rebound in exports as countries were able to reorient supply to the demand from the West.

Variations among countries. In the richer, pre-accession countries, the output decline was shorter, lasting on average 3.8 years, with a cumulative output decline of 22 percent on average. By 2000, gross domestic product (GDP) in most of these countries had recovered to 1990 levels. In some countries (Romania, Poland, Hungary), 2000 GDP was well above the 1990 level. The mix of production had changed, however, as industry shrank from 45 percent of value added to 33 percent, with the service sector picking up the slack. The private sector share of GDP in these countries ranged from 60-80 percent of GDP by 2000. Most of these countries experienced a very active and volatile labor market, with significant job creation and destruction. By the end of the decade, over half of employment was in the small and medium enterprise (SME) sector in most of these countries. In all countries except the Czech Republic (which had slower growth), employment growth lagged behind GDP growth. For example, in Hungary, after rising to nearly 12 percent, unemployment fell back to about 9 percent, where it remained for the second half of the decade, and long-term unemployment is an issue (World Bank 2001b). Wages initially fell, but by 2000 in most countries the average wage was near or above the 1990 level.

In the poorer countries of the CIS, as well as the conflict-ridden countries of the former Yugoslavia, the story is different—and worse. The output decline lasted on average 6.5 years, with a cumulative decline of 50 percent of GDP on average. Conflict-ridden countries such as Moldova, Armenia, and Azerbaijan lost over 60 percent of GDP, and Georgia lost 78 percent. By 2000, GDP had recovered to on average 63 percent of 1990 levels, but in Georgia GDP only recovered to 29 percent, and in Moldova it only reached 35 percent of 1990 levels. Product mix changed in these countries as well, with services growing to 50 percent of GDP, and industry and agriculture declining. The high service share in these

[3] The facts and analysis in this section are taken from World Bank (2002g).

countries reflects in part the growth of the informal sector, which has grown much faster in poorer countries (Rashid and Rutkowski 2001). The private sector share of GDP was a bit smaller on average than in the richer countries (50 percent compared with an average of 68 percent in the richer) but, more importantly, the variance is much larger, ranging from 20-30 percent in Belarus and Turkmenistan to 70 percent in Russia. The share of employment in the SME sector is on average smaller (around 20 percent, even in countries such as Russia with a larger private sector). Both of these trends reflected slow and incomplete restructuring of the state sector. Importantly, employment has not fallen as fast as GDP in most of these countries, although wages have declined sharply. For example, in Moldova and Russia, wages in 1998 were still less than 40 percent of the 1990 level. Often, employment was nominal at best, as wage arrears and wage non-payment (even these low wages) was common. This phenomenon, known as labor hoarding, partially reflected use of the state sector as employer of last resort (Rashid and Rutkowski 2001) but it also reflected the lack of alternative employment opportunities, as private sector growth was not as rapid and not creating jobs as effectively as in the richer countries. Unemployment (defined according to International Labour Organisation standards) is not regularly measured. Fragmentary data for countries such as Russia, Ukraine, and Moldova register double-digit levels, without the decline observed in the richer countries (Rashid and Rutkowski 2001).

Effects on people. The effects on households of these economic swings were dramatic. Under central planning, the command economy promised cradle-to-grave income security. Consumption levels not really "standards" but more how people lived may have been low, but they were secure. There were three legs to the system:

- Benefits in kind: low-cost housing and utilities, cheap transportation, and almost free social services such as childcare, education, and health care. There were quality issues but few access problems;[4]
- A guaranteed job; and
- Cash payments to households to support dependents—child benefits and pensions to support the disabled and the aging (the latter defined very liberally). There were also a range of special subsidies for various groups (either needy groups such as disabled veterans or groups deemed to be of particular merit such as party officials).

The transition affected all three legs. The drop in income and the development of a market economy knocked out the guaranteed job. The fiscal crisis that resulted from the income decline and initial difficulties in collecting taxes from the non-state sector forced large cuts in (a) and (c). As a result, households became at once poorer and more vulnerable. The vulnerability was exacerbated by the loss of financial savings, wiped out by the initial bout of hyperinflation and/or by subsequent banking system crises. While most households were able to retain their housing (their main source of wealth, and not a liquid one since there was no housing market), some households were forced to sell their consumer durables at low prices in order to survive. Households also suffered serious social and psychological costs, caused by the destruction of "normal life" (World Bank 2000b). Surveys reported isolation, shame, and feelings of worthlessness that despite their education and hard work, they could

[4] While access was broadly universal, rationing through queuing took place, for example, for housing. Good political connections could affect time in the queue as well as quality of service.

not find a job that paid adequately—or even any job at all. This was reflected in such indicators as rising divorce, alcoholism, suicide, morbidity, and mortality.

What did governments do to support households? Governments were severely limited in what they could do because of the transition-induced fiscal crisis. Governments needed in any case to scale back their size and scope to a level more consistent with a market economy, but the fall in output imposed an even greater cut in a short amount of time. For the richer countries, expenditures as a share of GDP stabilized in the range of about 40 percent, but poorer countries not only lost large chunks of output, but revenues as a share of the remaining output shrunk as well, to levels more common in very low-income countries (e.g., in Georgia, 9 percent of GDP).

Most governments followed four main policy lines:

- To help the unemployed, they instituted a system of payroll tax-financed unemployment benefits (linked to the average wage, so as wages fell, this benefit fell as well) and employment services. Early retirement was also encouraged—a policy which turned out to be very costly.
- To help pensioners, they tried to protect pensions, spending 7-15 percent of GDP on this item. As a result, during the bout of hyperinflation in the initial years, average pensions in all countries fell less than wages. As countries stabilized, average wages overtook average pensions in some countries, but spending remained high. However, in the poorest countries, pensions were sometimes not even paid as arrears built up.
- To help households, they raised housing and utility costs slowly (essentially forcing utility companies to run losses which were eventually covered by depreciation of capital, reduced expenditures on service (resulting in problem, such as blackouts and brown outs), and by subsidies (to failing companies), and offered vouchers to help tenants buy their housing. They cut back on social services offered (e.g., state-run kindergartens), but they resisted imposing costs for social services although informal payments to service providers increased substantially.[5] They kept child allowances, although at a reduced level, and some countries began to means-test them. Some kept the "merit" transfers as well. Sick and maternity leave programs from the planned economy period were retained for those employed in the covered sector (state enterprises, government, and large firms).
- They introduced various forms of welfare payments—some means-tested, some categorical, some nationally administered, some locally administered. They also increased offerings of residential care, and as a result the number of institutionalized children and adults increased rapidly (Tobis 2000).

In terms of the share of expenditures—financing for publicly provided services (health, education, utilities)—was usually the largest expenditure, as these were in any case often wage and other payments to state-owned entities. Next came pensions.[6] The next largest share was often expenditures on unemployment benefits, with direct welfare services the smallest. Many countries spent more on institutional care (for less than 4 percent of the

[5] See Lewis (2000) for an analysis of this issue.
[6] See Fox (1997) for a review of this issue.

population) than they did on cash transfers to poor households. In 1999, for example, it is estimated that Russia spent 50 percent more on residential care than on social assistance benefits (including Chernobyl victim assistance) and child allowances combined (World Bank 2002c).

What happened to poverty?[7] As is well known, poverty increased in all countries, even the most successful economic reformers. In the countries with the biggest income fall, poverty went through the roof. In 1990, an estimated 1.5 percent of the population in the region lived on less than $1 a day. By 1998, 5.1 percent of the population had fallen below this international poverty standard (World Bank 2000b. Using the standard of $2.15 a day (1993 PPP dollars)—a more reasonable standard given the higher costs for minimum consumption owing to the cold climate—poverty increased in the region from 2 percent to 28 percent between 1988 and 1998. Poverty rates varied substantially, however (see table 1), with predictably higher rates in the lower-income countries.

Inequality also increased substantially, especially in the lower-income countries (Table 1). Some increase in inequality was expected, as the planned economy had compressed wages substantially. This wage compression was, in the long term, inconsistent with open borders and a free labor market. But increases in inequality were not correlated with the intensity of market reforms. On the contrary, they tended to be higher in the partial reformers, reflecting "capture" of the formerly public assets by an elite group and the increase in corruption (World Bank 2000a and UNICEF 2001). For poverty, the effects of the inequality increase have been negative for several reasons. First, in the high-inequality countries, it may be reducing growth. Second, the inequality increase amplifies the negative effect on poverty of the output decline and reduces the recovery's positive effect on poverty. This is why, even in the fastest growing economies, poverty is still higher than before the transition. Third, growing inequality appears to have increased the psychological costs of poverty.[8]

An important aspect of the nature of poverty in the transition is that is it seems to be quite transient—households tend to cycle in and out of poverty. Many households were subject to large income shocks. As they had little savings or liquid assets, these shocks translated directly into expenditure shocks—consumption smoothing was not possible. Using panel data, investigators found that, in Russia, 45 percent of households were poor at least once in a four-year period, but only 3.4 percent were poor in all four years (Luttmer 2000, cited in World Bank 2000b). In Poland, similar analysis showed 32 percent poor at least once, but only 6 percent poor in all four years. In Hungary, the numbers were 9 percent and 26 percent. Even in poor Georgia, over 80 percent of the population escape poverty over the course of a year (World Bank 1999b).

[7] This poverty section is taken from World Bank (2000b). See the same source for an extensive discussion of the measurement issues.

[8] The high psychological costs of poverty in the transition are well documented in a series of qualitative studies of poverty commissioned by the World Bank and others. These are summarized and cited in World Bank (2000b).

Table 1: Absolute Poverty Rate and Evolution of Income Inequality During the Transition

Country	*Absolute poverty headcount ($2.15/day)*[a]	*Gini coefficient for income per capita*		
		1987-90	*1993-94*	*1996-99*
Central Europe				
Czech Republic	0.0	0.19	0.23	0.25
Hungary	1.3	0.21	0.23	0.25
Slovak Republic	2.6	—	—	—
Slovenia	0.0	0.22	0.29	0.25
Poland	1.2	0.28	0.28	0.33
Southeastern Europe				
Albania	11.5	—	—	0.27
Bulgaria	3.1	0.23	0.38	0.41
Croatia	0.2	0.36	—	0.35
Macedonia, FYR	6.7	—	—	0.37
Romania	6.8	0.23	0.29	0.30
Baltics	—	—	—	—
Lithuania	3.1	0.23	0.33	0.34
Latvia	6.6	0.24	0.31	0.32
Estonia	2.1	0.24	0.35	0.37
Slavic countries				
Russian Federation	18.8	0.26	0.48	0.47
Ukraine	3.0	0.24	0.47	0.33
Moldova	55.4	0.27	—	0.42
Belarus	1.0	0.23	0.28[c]	0.28
Caucasus and Central Asia				
Armenia	43.5	0.27	—	0.59
Azerbaijan	23.5	—	—	—
Georgia	18.9	0.29	—	0.43
Kyrgyz Republic	49.1	0.31	0.55	0.47
Kazakhstan	5.7	0.30	0.33	0.35
Tajikistan	68.3	0.28	—	0.47
Turkmenistan	7.0	0.28	0.36	0.45

— not available
[a] Mostly 1998-99, see source for details.
Source: World Bank 2000b, pp. 35 and 140.

Related to the above is the subjective perception of poverty in CECA countries. The income shocks referred to above were not viewed positively by the population.[9] When Russians were asked in 1993 what their idea of a minimum poverty line would be, the response generated a number which put 90 percent of the population in poverty—about 3-4 times the official estimates (Ravallion and Loshkin 1999). As the economic decline continued, however, this subjective poverty line gradually fell, so that by 1997, only 60 percent of the population was in poverty according to the people's views about a poverty line. While people's expectations gradually lowered, there was still broad feeling that poverty was widespread. Even in countries where income levels had recovered and most of the population was better off in expenditure terms than they had been in 1990, many reported being worse off since the transition began.[10]

Who are the poor? The correlates of income poverty show significant commonality across transition economies. In general, the aging are not over-represented among the poor. Contrary to initial expectations, this group has mostly stayed above the poverty line, for several reasons. First, high (often unsustainable) pension expenditures have supported this group. Second, retirement ages are low. As a result, most continued to work for at least 10 years after retirement, providing a second source of income. Third, most were the beneficiaries of housing privatization or land repatriation. While it was difficult to sell this asset and increase cash income, housing (and associated land) did provide a way to make a subsistence, through a kitchen garden, for example. There is a small subset of older pensioners (over 70) in richer countries, often living alone, who have faced poverty and deprivation. These are usually women, owing to an average 10-year difference in life expectancies. In poor countries, where pensions have been cut and arrears have built up, poverty among pensioners is increasing. In these countries as well, single pensioners face a high risk of poverty (e.g., Georgia, Moldova).

As in the rest of the world, a higher dependency ratio is correlated with poverty as larger households, especially households with children, are more likely to be in poverty. This is the case even when household income or expenditure data is corrected for economies of scale, using an equivalence scale. While few households in the European countries have more than two children, those that do, especially if there is only one earner, have a high probability of poverty.[11] In poorer areas such as the Caucasus, families have increasingly formed multi-generational households as a coping strategy, but these households still have a higher probability of poverty when children are present. The one exception is single-headed households with children where another earner has migrated but sends remittances. Remittances are a significant factor in helping prevent poverty in Armenia (Murrugarra 2002).[12]

The main causes of poverty in CECA countries are low earnings among working parents (including among the employed in countries where wages are paid infrequently) or lack of

[9] This is another reminder of the well-known result that variance matters to people as much as mean. Many studies have shown that people are risk-averse, and are willing to trade off rate of return for lower risk.
[10] See World Bank (2002b) for a discussion of this issue in Bulgaria.
[11] For example, in Latvia, the relative risk of poverty more than doubles if a household has more than two children. However, only two percent of households in Latvia fall into this category (Gassmann 2000).
[12] It is unclear whether the uneven flow of remittances accounts for the high rate of transient poverty but much lower rate of chronic poverty in Armenia.

earners in the household.[13] Households headed by unemployed or non-working adults have the highest poverty rates. This indicates that the unemployment insurance and active labor market policies have had limited effectiveness compared to, for example, the pension programs.[14] One reason is long-term unemployment, which is not eased by unemployment insurance because benefits are limited in duration. In Bulgaria, for example, 64 percent of the unemployed had been out of work for more than one year. Another reason is lack of eligibility. Those who left the state sector to work in the informal sector may not be covered.

More common than unemployment as a cause of poverty, however, are low wages (or low self-employment income). In Poland, Lithuania, Moldova, and Georgia, over 70 percent of poor households have an employed head.[15] The problem is the income of these earners. As wage differentials widened, especially between more and less educated workers, households where the earners have less human capital find themselves more often in poverty. In Russia, 34 percent of employees have monthly earnings below two-thirds of the median (compared with 14 percent on average in OECD countries) (UNICEF 2001). Many of these low earners live in poor households. In Ukraine, education of household head is the strongest correlate of poverty (World Bank 2001e). In Bulgaria, individuals over 18 with less than secondary education have 10 times the poverty rate of their more highly educated colleagues. However, in countries where real wages fell more and higher levels of wage arrears and labor hoarding persist, more education does not reduce the risk of poverty substantially. For example, in both Armenia and Georgia, the relationship of education to poverty is very weak (World Bank 1999b, 1999c).

In most countries, rural poverty rates are higher, reflecting the difficulties in the agricultural sector, which is now open to competition from efficient producers overseas, especially in the richer countries and those near the coast. In Bulgaria, rural residents make up one-third of households but two-thirds of the poor; in Poland and Latvia, rural residents have a 50 percent higher risk of poverty (UNICEF 2001). In these countries, the agricultural sector has a large number of basically subsistence farmers and a minority of more prosperous commercial farmers. If a rural household has additional sources of income (e.g., wages and/or pensions), it is less likely to be poor than if it has to depend on its own production. In the poorer countries, the economy is so depressed that both urban and rural areas are poor, and access to land for subsistence farming has actually been part of the safety net. Common to rural areas in all countries is less access to government support in the form of cash transfers (except pensions) and heating subsides (which tend to reach mostly urban households), and lower-quality public services such as education. This has contributed to growing rural poverty and increased the severity of rural poverty.

In urban areas, capital cities are booming. Residents there tend to have the best access to public programs, including safety net programs. Outside of the capital, many countries find pockets of poverty in one-company towns where the main factory closed. This is in part caused by sluggish labor mobility. Older unemployed workers, in particular, find it difficult to move for many reasons, including the cost of relocation and the disruption of social

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[13] World Bank 2000b, pp. 70-71.

[14] This is not necessarily a shortcoming as the main objective of both pensions and unemployment insurance is income smoothing which is related to, but not the same as, poverty reduction.. However, the weak performance of unemployment insurance in reducing poverty does raise questions about other designs which might reduce some benefits to target more assistance to the long-term unemployed.

[15] World Bank 2000b, p. 95.

networks. Finally, ethnic minorities are at high risk of poverty, as are areas populated by these minorities. In Bulgaria, the Roma are ten times more likely to be poor than ethnic Bulgarians, while Turks are four times more likely to be poor (World Bank 2002b).

The problem of equivalence scales, or do we really know how to measure poverty? Most of the poverty estimates presented in this paper are headcounts of people whose household per capita income is below a poverty line. In most cases, this is corrected by an equivalence scale, which reduces the denominator in the fraction (household income/number of people in the household) when the household has two or more people in it to adjust for economies of scale in household production (based on the old idea that two can live more cheaply than one). In uncorrected data, the elderly are consistently less poor than families with children because they tend to live in smaller households. Once a correction is made, the share of the elderly poor tends to rise in all countries (although few households with many children drop out, indicating that poverty is still more severe in this group). Is this the end of the story?

In a recent paper, Lanjouw, Milanovic, and Paternostro (1998) attempt to pull the question of equivalence scales apart a bit more. They note that a household typically consumes both shared goods and services (housing, utilities), and individually consumed goods (food, medical care). The basket consumed (and needed) by the latter differs depending on demographics. Households with children buy more education for example, while, those with aging members tend to buy more health care. An equivalence scale typically captures (and combines) two dimensions: (a) the relative price of shared goods vs. individual goods, and (b) the relative price of goods and services consumed by children vs. those consumed by adults (including the aging). In economies where these relative prices are stable, the use of one factor to adjust for both dimensions may be appropriate. However, in transition economies, both relative prices have been shifting as subsidies are removed and the economy opens to imports. Most shared goods, such as housing and utilities, have become more expensive. Some individually consumed goods, such as some foods, have become relatively cheaper, while others (e.g., education and especially health care) have become more expensive. As a result, over the transition period, the relative cost of a basic basket of goods has changed several times. This implies that there may not be a reliable equivalence scale for the period.

Two implications follow from this analysis. First, poverty headcounts (even when adjusted by an equivalence factor) and in particular intertemporal comparisons of poverty in transition economies are subject to significant "noise." Lanjouw, et. al., suggest in their conclusion that the best way to look at household risk of poverty is by total dependency ratio—the fewer earners (including pension earners) in a household, the higher the likelihood of poverty. This is clearly and obviously true, not only in CECA. Secondly, and more important for policy, these relative price changes have subjected households, even middle-income ones, to significant and unexpected shocks which have been difficult to manage. This has added to the subjective perception of poverty and to the psychological costs of the transition. For the aging on fixed incomes, adjusting to these relative price changes has been particularly hard. It is no wonder that, while not generally poor, this group is often the most dissatisfied with its living conditions under the transition, a position which usually garners wide public sympathy and support.

Reducing poverty: The Role and Effectiveness of Safety Net Programs

As noted above, countries used a range of public interventions to fight poverty. The vast majority of these (classified by expenditure) was untargeted (Box 1), implying that most of the benefits went to the non-poor.

Box 1: Evaluating the Poverty Reduction Effectiveness of Transfer Programs

The effectiveness of a transfer program in reducing poverty (the extent of targeting) can be characterized in several ways:

- *Coverage*: the percent of the poor who receive the benefit
- *Leakage*: the share of expenditures which goes to the non-poor
- *Adequacy*: the average share of the benefit in total household consumption or, alternatively, the poverty head count (and/or poverty gap) without the benefit.

A benefit can have different rankings on each dimension. For example, untargeted, income smoothing programs such as public pensions or unemployment insurance tend to have high leakage but also a high effect on the poverty rate. Safety net programs are not designed primarily for income smoothing but instead for reduction of absolute deprivation. Ideally, these programs should have high coverage, low leakage, and high adequacy. Universal or contribution-based programs are excellent for social risk management, but can be expensive poverty reduction programs compared to more targeted safety net programs. However, if these broader programs are not in place, getting an equivalent poverty reduction with targeted programs would be more costly and perhaps less politically sustainable (see Graham 2001 for a discussion). A key issue is the expenditure mix, especially when insurance benefits are financed on a pay-as-you-go basis.

In Russia, recent analyses have found that many safety net programs are untargeted. Overall, a government study found that only one-third of total safety net expenditures reached the poor—two-thirds leaked to the non-poor. Fuel and rent subsidies are a good example. Subsidies were allocated disproportionately to the two richest cities—Moscow and St. Petersburg, where 36 percent received a subsidy compared to only 6 percent in rural areas. As a result, there was high leakage. In 2000, 14 percent of expenditures went to the poorest quintile of households, while 21 percent went to the top quintile. Richer households also received a higher absolute amount. Child allowances fared better, but still had substantial leakage, as 23 percent of total expenditures went to the poorest quintile, while 15 percent went to the richest.

Three basic patterns of policy and programmatic responses can be observed: (a) the middle-income, fast-reforming countries (mostly the pre-EU accession countries), with high spending and the lowest poverty rates in the region; (b) the slow-reforming, middle-income countries, where poverty rates are significantly higher than in the first group despite high spending; and (c) the low-income, often slow-reforming countries, where poverty rates are highest and social expenditures are lowest (relatively and absolutely).

Middle-income, faster-reforming countries (EU-accession countries): In these countries, social spending was usually 15-20 percent of GDP (or more), with cash transfers to households absorbing the largest chunk. As a result, cash transfers were an important source of income for the vast majority of households. In Romania and Bulgaria, for example, over 80 percent of households received at least one benefit in 2001. In terms of safety net benefits, child benefits were the largest expenditure item. A means-tested social assistance system was introduced in all countries during the early years of the transition. Coverage in these systems was low according to a study done in 1999, although several countries have recently made improvements in their policies and administration (see Table 3 and Annex 1). However, most countries still devote a very small fraction of total social expenditures to means-tested programs. For example, in 2000, Romania spent 16.7 percent of GDP on social sector current expenditures, with nearly 60 percent going for social insurance and categorical benefits. Slightly over 1 percent was spent on means-tested social assistance.

Hungary's expenditure pattern is typical. In 1997, 65 percent of households received either a pension or a family allowance, but only 9 percent received social assistance. Thirty-eight million forints were spent on social assistance payments, but 306 *billion* forints (about 1.1 percent of GDP) were spent on family benefits (World Bank 2001a). This implies that social assistance programs constituted less than 1 percent of total social spending, compared with about 3 percent in Germany and the United Kingdom, 4 percent in the United States, and 5.6 percent in Sweden. Few countries made use of scholarships or fee waivers, relying on broad-coverage health insurance programs and universal free primary and secondary education. Outside of (mostly) free social services, subsidized provision of privately-consumed goods was limited.

This pattern of spending has been much debated, with the progressive but untargeted nature of most spending noted. There is no doubt that the package of high social insurance spending combined with child allowances and small social assistance programs prevented the poverty. In the Hungarian case, it is estimated that poverty would have been a third higher without child benefits and poverty would have doubled without the public pension program.[16] In Bulgaria, it is estimated that poverty would have been almost double in 2001 without government cash transfers. At the same time, the leakage[17] for these programs is high, especially for social insurance programs, which by their nature are not targeted and therefore are designed to be "leaky." But even in the case of child allowances, only 20 percent of expenditures in Hungary went to the bottom quintile, compared with 46 percent for social assistance (World Bank 2000b, 2001a).

In terms of allocation of resources among programs, overspending on pensions has been criticized (Fox 1997; Fox and Palmer 2001; Heller and Keller 2001;World Bank 1994 and 2000b) and the role of child allowances has been debated as spending has fallen in real terms (UNICEF 2001, Förster and Toth 2001). Implicit in this criticism is that, if there had been less spending on pensions and other untargeted insurance and assistance programs, more would have been available for targeted poverty relief. With respect to child allowances, most analysts now conclude that, at current expenditure levels (spending is usually less than 1 percent of GDP), these are fairly ineffective anti-poverty strategies, but should be kept for other reasons. Raising children has high social externalities so is worthy of support, and the alternative of using tax credits would be much more regressive (World Bank 2000a, Andrews and Ringold 1999, UNICEF 2001).

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[16] Of course, this type of static analysis has serious limitations as it assumes no behavioral response if the payments dried up. It is more likely that some of the lost income would have been made up by private transfers, since it would have been left in employee's wages, not collected as taxes. Labor supply among older workers would be higher as well.

[17] Leakage is percent of expenditures that goes to non-poor households. For example, although unemployment is highly correlated with poverty in Bulgaria, only one-third of the amount spent on unemployment benefits, including unemployment assistance, went to poor households.

With respect to pensions, the jury is still out on the costs and benefits of the high levels of spending. There will be high fiscal costs for a long time, potentially lowering investment and growth. However, Keane and Prasad (2000) argue that this high level of cash transfers to households helped to maintain social cohesion—a necessary condition for the reforms, which brought growth. Several recent analyses have concluded that the system overall has discouraged labor supply. This is one reason that employment levels have not recovered – there appears to have been substantial withdrawal from the labor force, which raised dependency ratios and lowered economic growth.[18] Unemployment benefits combined with social assistance in Slovakia supported a longer duration of unemployment (Sánchez-Páramo 2002), but also an effective transfer of labor into the private sector. The level of spending on health and education is generally not criticized. Access to social services in these countries is generally good, and the risk of high medical payments causing poverty is low. Usually, studies find the poor spending less than 10 percent of their income on out-of-pocket costs for health care or education, so this aspect of the social protection system worked well.

Middle-income, slower-reforming countries. These countries spend about the same amount on health and education as the low spenders in the above group (about 10 percent of GDP). The main difference is that these countries spend more on subsidies to households for private goods—housing, utilities, fuel, telecommunications, transport, credit, cars, prescription drugs, health resorts, etc. They also tend to have a broad range of benefits provided to categorical groups—war veterans and their families, occupational groups, etc. Often there are more than 100 benefits, in a system which had its origins in Soviet times and has expanded dramatically since (World Bank 2001d). These tend to cost 3-5 percent of GDP and are not targeted. One large expenditure item has been spending on war veterans and other victims of catastrophe (e.g., Chernobyl), which is exceedingly popular but rarely progressive. This has been a particular problem in Bosnia and Ukraine. Benefits from these complex systems tend to accrue disproportionately to those in the urban, state-owned sector, leaving the rural poor behind. For example, housing and utility subsidies benefit upper-income dwellers more, since they have larger dwellings, and tend to benefit urban residents. The rural poor, relying on wood, coal, and other unsubsidized heating fuels, do not benefit.

The slow-growing, middle-income countries spend significantly less on child allowances, and little if anything on means-tested programs—in Ukraine, 0.4 percent of GDP was spent on family allowances and 0.5 percent on means-tested social assistance in 1999. In the same year, a little over 4 percent of GDP was spent on health and 10 percent on pensions (World Bank 2001d).[19]

Safety net expenditures tend to be less targeted than in the fast-reforming countries. This is not surprising, given the complexity of the benefit systems, which are a combination of old Soviet merit-based ones and new programs initiated during the transition (e.g., energy subsidies). As many of the benefits are nationally mandated but locally financed and administered, they are not usually progressive, since poor areas are not able to finance them and tend to run arrears. For example, in Kazakhstan in 1996, only 6 percent of general social

[18] In a general equilibrium system, increasing factors of production increases economic growth and vice versa. . It is arguable that, in the early years of the transition, aggregate demand deficiency was so great that increasing labor supply would not increase growth, but over the medium term, surely the growth costs are being felt. See World Bank (1994) for a discussion of this point.
[19] As a benchmark, this compares with Germany and the United Kingdom, which spent 7 percent of total public social welfare and health expenditures on child allowances.

assistance expenditures went to the poorest 20 percent of households. On the other hand, these countries are more likely to means-test child allowances, improving the targeting. In Kazakhstan, 24 percent of the means-tested child allowance expenditures went to the poorest quintile. There is some evidence that household financing of social services tends to be higher in these countries, as there is a higher incidence of informal payments and user fees—roughly correlated with levels of corruption.[20] Public safety net programs do not seem to be addressing this issue.

Spending patterns in these countries can be faulted both for the poor targeting of the safety net benefits as well as for the overall social protection expenditure mix—too much spending on insurance programs, which do not benefit the poor and encourage withdrawal from the labor force. Both issues bite harder in these countries because poverty rates are higher in this group of countries, and therefore needs are higher. Spending on insurance-based cash transfers and formal employment-linked safety net benefits may have a more regressive impact in these countries owing to the size of the informal sector (where, for example, subsidies linked to employment would not be available). For example, pension coverage is declining rapidly as the informal sector grows, but retirement ages are still quite low, so dependency burdens are rising. The complexity of the system has also been cited as a source of corruption, as rationing systems are not clear.

Targeting is considered administratively feasible in these countries (e.g., Russia, Kazakhstan, Ukraine), but it seems politically unpopular. The exception is child allowances, where this group of countries stands out as more likely to impose means tests (Belarus, Ukraine, Uzbekistan). Another exception to this weak performance in targeting safety net programs is the Mahalla program in Uzbekistan, a flexible benefit allocated by local community groups. It is progressive and has low overhead costs (Coudouel, Marnie, and Micklewright 1999). It has a leakage factor of about 40 percent - not a bad ratio in CECA countries. Mahalla committees also administer the means testing of child allowances, with similar results. In 2000, 26 percent of households in the poorest quintile received benefits, compared with only 6 percent of the richest quintile; 54 percent of expenditures went to the bottom 40 percent. Overall, child allowances are estimated to reduce the headcount of poverty by two percentage points. However, a recent analysis cites complex application procedures as a barrier for some poor applicants, and notes the need for monitoring to insure that political judgements do not cloud the decentralized award decisions (World Bank 2002h).

Low-income countries. Safety nets in low-income countries are generally poor. This is primarily because the needs are greater and the means less. The collapse in fiscal systems has meant that financing for education and health have fallen sharply—in most countries to 3 percent of GDP or below for each. Private financing (out-of-pocket costs paid by households) has increased, and as a result, access is a problem. In Tajikistan, 37 percent of pregnant women did not seek pre-natal care due to its cost, and in the Kyrgyz Republic, over 45 percent of rural households reported selling assets to finance health care (Lewis 2000). In

[20] This pattern is not clear cut. In Bulgaria, only 21 percent of patients reported making informal payments, but in Poland, 78 percent reported making these payments—higher than in Russia. The difference seems to be in the magnitude as a share of income. In Russia, 74 percent reported making these payments, comprising on average 3.5 percent of total household spending (Lewis 2000). In Romania, 54 percent of households reported making payments, but the average payment was only 0.6 percent of total household spending per capita (World Bank 2001a).

these countries, a minimum element of the safety net—protection from the risk of poverty due to health care expenditures—is not present.

Many of these countries also have the range of social assistance benefits and privileges of their higher-income neighbors from the former Soviet Union (FSU). For example, Moldova has over 100 different benefits, costing over 3 percent of GDP (World Bank 1999c). Armenia had a similar pattern before the 1999 reform (see below). But in these countries, few of the legal obligations are honored, given low funding. In Moldova, only 56 percent of the estimated cost of the benefits was included in the budget in 2000.[21] As a result, a rationing process occurs, which is usually non-transparent and favors urban areas. Arrears in benefits are also common. In Georgia in 1997, only half of the planned allocation on child allowances was actually spent. When they are paid, social insurance payments are also lower in these countries. In Armenia, unemployment benefits were reported to be so low that few of those eligible claimed them (de Neubourg and Morris 1999). Similar problems are reported elsewhere—high administration time for very small benefits. Utility subsidies, when provided, tend to be regressive, as they are concentrated on urban households in the capital cities (in the form of tariff reductions or arrears forgiveness).

Armenia and Kosovo have both been recognized as countries which put in place a successful targeting system to allocate emergency safety net foreign aid. Both countries relied mostly on categorical variables to estimate need, because calculating and estimating incomes would have been very time consuming, with a high degree of error. The Armenian system had a fairly complex formula with a large number of variables. In simulations, simpler formulas performed equally well, however. Errors of exclusion were not very high in either system compared with the richer countries, and seemed to primarily stem from complex registration and difficulties in evaluating assets. In Armenia, non-governmental organizations (NGOs) are also an important source of targeted aid (World Bank 1999b).

Selling assets, labor migration, and relying on informal safety net transfers from family clan and community members are the dominant coping mechanisms for the poor. In Albania, these informal mechanisms and community structures are used to effectively target safety net funds. Community targeting seems to have worked well to insure that over 60 percent of expenditures from the Ndihme benefit program in Albania, which is allocated by local groups, goes to the poorest households.

Use of social care to help families in crisis. A key feature, and a tragic legacy, of most CECA economies prior to the transition was the use of residential institutions for social care. Frail elderly and disabled adults and children, children who lost one or both parents, and children born into difficult circumstances (to poor teen or single mothers, for example) were, often at the urging of the social services network, placed into residential care, where they were excluded and marginalized, and they died. A 1999 estimate found over 1.3 million people, the majority of them children, in these care institutions. The number of people in care has nearly doubled over the transition period, while conditions deteriorated (table 2). The increase in people in care is another reflection of the stress the transition placed upon families.

[21] Moldova is in the process of reforming these benefits.

Table 2: The Number and Rate of Children in Out-of-Home Care, by Main Sub-Region, 1989 and 1999

	Absolute number (1,000s)			*Rate (per 100,000 0-17 year-olds)*		
	1989	*1999*	*Difference*	*1989*	*1999*	*Difference*
Central Europe	276.6	290.3	13.7	1,507	1,916	409
Former Yugoslavia	41.1	28.2	–12.9	635	504	–131
Southeastern Europe	154.2	134.8	–19.3	1,529	1,680	151
Baltic states	15.7	32.8	17.2	748	1,860	1,112
Western CIS	829.0	908.0	–10.7	1,436	1,871	435
Caucasus	54.1	43.4	–10.7	971	796	–175
Central Asia	87.6	114.9	27.3	402	495	93
Total	1,458.2	1,552.5	94.3	1,194	1,441	247

Source. UNICEF (2001), p. 97.

It appears that the use of these institutions has been a key part of the safety net. Children from poor families and from ethnic minorities are much more likely to end up in care as the free room and board operates as an income substitute. Yet not only is this type of custodial care very damaging for children, it is also much more costly than supporting the children at home. Countries are beginning to tackle this problem through reform strategies, designed to both change the approach of key points of contact for troubled families toward a more inclusive one, and to support the development of new, community-based services, which are usually cheaper, better, and reach a broader share of the population.[22]

Analysis of Safety Net Experiences

Throughout most of the first decade of the transition, safety net programs, especially means-tested cash social assistance, played a very small role in poverty reduction, except in a few countries. This result is not surprising, as means-tested programs were usually poorly funded and often poorly administered, resulting in poor targeting. For example, in Bulgaria and Estonia at the middle of the decade, only 3 percent of households received anything at all from the social assistance system. Even so, in Estonia, over 50 percent of those households were not classified as poor by the national poverty line. In Lithuania in 2000, only 13 percent of poor households received the benefit and, as a result, the income-tested social assistance programs reduced poverty by roughly one percentage point (a 15 percent reduction).

Categorical benefits, such as child allowances and subsidies on public services for the aging or for public workers and their dependents, have also consumed a higher share of resources than means-tested programs, although the share of these programs in total social expenditures has been falling with the fiscal crisis. Most analyses find that the energy subsidies were not targeted (World Bank 2000a). Child allowances present a mixed picture. In countries such as Uzbekistan, where categorical child allowance benefits are means-tested, effectiveness has been higher. In countries with well-administered universal child benefits

[22] For a discussion of the problem and reform solutions, see Tobis (2000) and UNICEF (2001). For a discussion of financing issues, see Fox and Gotestam (2002).

(such as Hungary), these benefits, while not targeted, are at least progressive, with a modest poverty reduction impact. In Lithuania, the universal child benefit for children up to age 3 only reduced poverty by 8 percent. In countries where benefits are not universal but not means-tested (such as Bulgaria) or where administration is poor and funds do not reach the poorest areas (such as Russia and Moldova), the expenditure seems to be regressive.

Several middle-income countries have made improvements in their means-tested cash benefit systems since the data in Table 3 were collected, suggesting that the effectiveness of safety net programs in poverty reduction is growing. In Estonia by 2000, 12.3 percent of poor households received the means-tested benefit. Poor households were now receiving 37.7 percent of total means-tested social assistance expenditures.[23] In Romania, significant efforts have been made to insure adequate funding. These efforts paid off and, by 1999, the poorest 20 percent received over three-quarters of the expenditures on the means-tested social assistance benefit, and the poverty rate was reduced by 37 percent (World Bank 2002f). In Bulgaria in 1997, only 18 percent of the benefits of the cash and in-kind social assistance programs went to the poorest quintile, but by 2001, 68 percent of expenditures went to the poorest quintile (World Bank 2002g).

Table 3: Coverage, Targeting Efficiency, and Effectiveness of Benefits in Selected CECA Countries, 1993-95

Indicator	*Poland*	*Hungary*	*Bulgaria*	*Russian Federation*	*Estonia*
Percentage of Households below national poverty line	38	8	2	36	3
Coverage of Social Assistance benefits					
Percentage of households	4	24	3	13	3
Percentage of poor	6	43	10	13	10
Inclusion errors[a]	36	86	92	84	65
Exclusion errors[b]	94	57	90	87	90
Targeting efficiency[c]	21	27	22	8	35
Effectiveness[d]	22	5	4	4	15

Note: Poverty line is the national poverty line for each country.
a. Share of the non-poor who receive social assistance.
b. Share of the poor who do not receive social assistance.
c. Share of total transfer expenditures to bottom decile.
d. Social assistance as a share of expenditures of recipients.
Source: Braithwaite, Grootaert, and Milanovic (2000).

Why were means-tested programs initially such a small part of the expenditure mix? Although most advisors recommended putting in place means-tested social assistance programs at the beginning of the transition (see for example, Barr (1994)), these systems did not live up to expectations, either in coverage or in targeting efficiency. Part of the reason that means-tested social assistance systems played such a small role is that countries tended

[23] Personal communication, Arvo Kuddo, based on Estonian sources.

to rely on the institutions they already had—especially social insurance, but also "privileges"—with differing results.

In the richer, faster-reforming countries, this strategy worked best. These countries were able to combine existing social sector institutions and structures such as the social insurance and public social service financing and delivery system with market-based systems such as a competitive labor market and housing privatization to prevent and alleviate poverty. In part because of the effectiveness of the reform program, the proliferation of "privileges" for urban public sector workers did not appear as it did in middle-income FSU countries. In the fast-reforming countries, social assistance was used sparingly, to pick up the small slack, and the slack was smaller given the strong coverage of the non-targeted programs.[24] This approach was costly, but it was made possible in part by better economic performance that is attributed to a more successful reform program. However, the long-term costs (especially of the pension programs) are worrisome. Many of these countries are now improving their means-tested programs as part of a continuing effort to control cash transfer costs while reducing poverty. For example, after successful reform of the social insurance system, Latvia has recently enacted legislation to strengthen the largely ineffective, locally-administered safety net programs into a national Guaranteed Minimum Income program, which is expected to fill in the gaps left by the tightening of eligibility requirements for social insurance as well as the reduction in benefits.

In the middle-income, slower-reforming countries, the strategy did not work so well, for two reasons. First, the problem was more economically difficult. The fiscal crunch was worse, so there was less money for the programs, yet more poverty. Second, slow reformers tended to have a higher subjective perception of poverty because growth was slower. As a result, the safety net programs often degenerated into attempts by interest groups to recoup some of their losses (the hundreds of privileges). Pro-poor public programs were more likely to be neglected in favor of complex, basically unaffordable cash transfer systems that were therefore governed by non-transparent rationing. The result was less efficiency in a more difficult situation. This is disappointing in these countries, as the means to reduce poverty seems to be present, as well as the administrative capacity to implement programs.

The low-income countries seemed to be overwhelmed by the extent of the income decline. The existing programs and institutions which delivered results in the middle-income countries, especially the faster reformers, fell apart in low-income countries. Benefits were not paid, or not paid on time. The required readjustment of resources to improve the efficiency of spending and put resources into means-tested programs seemed to be too much. Most of these countries never even developed a strategy. Two low-income countries that appear to have developed successful means-tested programs (Armenia, Kosovo) were in effect forced to develop these by donors, as a condition of access to funds.

The complexity of the targeting problem is an additional factor that contributed to the small role and low effectiveness of means-tested social assistance (Grosh 1994). Targeting

[24] Note that even in OECD and middle-income countries with good-practice safety net systems, expenditures and coverage of these systems is well below public expenditures on social insurance. This is normal, as social insurance programs have a much broader coverage. However, even in the best-performing countries, the expenditure mix in CECA is highly skewed toward non-means-tested programs. Means-tested programs absorb a much smaller share of resources than in OECD or good-practice middle-income countries. See, for example, OECD (1998).

problems require measurement of household resources and needs, as well as finding agents to disburse the assistance. This was even more difficult in the transition economies during the first decade for the following reasons.

- *Newness of the concept.* Targeting according to income was a new idea that, based on the evidence above, has not really taken hold. Old ideas regarding giving benefits to categories of people seemed to fit the political mood better. The social assistance systems that emerged seemed to be a mix of Soviet-style privileges and Western targeting. From this point of view, the political economy of poverty in some CECA countries seems closer to the North American idea of the "deserving poor" than to the European one of ensuring that no one goes without (Graham 2002). With respect to attitudes toward spending on safety nets for minority ethnic groups, there is strong similarity between American and Eastern European views. This seems to be especially the case in more decentralized systems, where local autonomy does not protect minorities.
- *High subjective perception of poverty.* Overall GDP fell so much that everybody felt poor. A strategy to compensate the losers for the costs of reform would have had to reach almost everyone in the early years. In addition, household income was volatile. As relative prices changed, needs changed, changing the profile of poverty. Poverty was also shallow, making it hard to separate the poor from the non-poor. In this case, rationing of public resources to fight poverty through targeting was difficult—there was probably not broad agreement on the objectives.
- *High transient poverty.* Related to the above point, many middle-income households that would not be in poverty in other middle- or lower-income countries after a macro or stochastic income shock ended up in transient poverty several times in CECA countries primarily because their savings were wiped out by inflation. They had no private risk-coping mechanisms. The most effective anti-poverty mechanism for these people would be stable economic growth and improvements in the safety and stability of the financial system.
- *Informalization.* At the same time, a new feature emerged – the informal economy. This made it much harder to assess household means, as many in the informal economy are not poor. Measures to address this problem that have been successful in Latin American countries (e.g., proxy means tests) were not as successful in CECA countries. The main reason was that the proxy variables such as education of earners or housing conditions which separate the poor and the non-poor in households in Latin America (where the income of poor households comes primarily from informal sector employment) do not separate households very well in CECA countries.
- *Social assistance delivery systems were weak.* All transition countries suffered from a gap between what was in the law or decree passed in the capital and what happened on the ground. The administrative requirements of targeting can be complex, and this was not often understood in legislative and executive branches, so the laws were often difficult to follow in practice (de Neubourg and Morris 1999). In most cases, new local offices had to be set up to handle this job. There were few trained social workers able to perform the required quality control functions.[25] Hence, studies found high errors of both inclusion and exclusion. On

[25] In Latvia, decisions on who got non-categorical social assistance benefits were left completely to local discretion. . In smaller towns and more remote areas, the mayor often decided who got benefits (and whether

the other hand, the delivery systems for social insurance and categorical benefits were already in place. The same is true of family services; institutions for children at risk and other vulnerable groups were already in place, while there were few models of community-based, inclusive services. Note that when countries tried to use the social insurance apparatus for delivering safety net benefits, the informal and rural sectors were often excluded (e.g., Bulgaria).

A final factor was the extensive fiscal decentralization which most CECA countries enacted, usually while overall tax revenues were falling. Social assistance was often included in the expenditure assignments. Cash-strapped local governments tended to spend funds first to maintain the infrastructure they owned and to pay salaries. Poverty reduction through means-tested social assistance was a lower priority. Braithwaite, Grootaert, and Milanovic (2000) found better targeting of means-tested social assistance in countries that had national financing of social assistance, as has been confirmed in a number of World Bank country-level studies (e.g., Bulgaria, Latvia, Romania, Russia). Safety nets need at least some national financing and monitoring to ensure effectiveness. Note that the combination of national financing and local administration seems to work in Uzbekistan.

Looking Ahead: Lessons for the Future for Transitional and Other Countries

The first lesson from this experience comes from the richer, fast-reforming countries, and is an obvious one. Sustained economic growth reduces poverty. This is especially true in transition economies, where most of the poor are not marginalized or excluded, most earners in the household have skills and are capable of work, and poverty is often transient. Indeed, growth has lifted these richer countries out of the "transition" category, as they will soon be EU members. This makes a strong argument for redirecting public resources in the slower-growing, middle-income countries to investments that support growth and away from expensive and complex "compensation" or "privilege" systems. Unfortunately, this case is currently not persuasive in many countries—especially for those who benefit—leading to political gridlock over this issue.

In terms of the policy and program mix, Table 4 reviews the standard list of safety net programs used most frequently in middle- and low-income developing countries, and comments on the application in transition economies. Several recommendations stand out.

Table 4: Typical Safety Net Programs, Experience in CECA and Options for the Future

Type of Safety Net Intervention	*Transition Economy Experience*	*Comments and Recommendations*
Family benefits and non-contributory pensions	Widely used; sometimes means tested. Progressive although without means testing not well targeted.	Continue use; insure access outside urban and formal sector. Try to exclude upper-income groups through income ceiling.
Means-tested cash	Most countries have some	High priority for middle-income (non-IDA)

they were in kind or in cash)—a nice source of petty corruption and vote buying. Social insurance and categorical transfer delivery systems were centralized, and subject to much greater supervision and control.

assistance	program; expenditures low and targeting often weak.	countries as key poverty reduction measure. Countries should improve practice and insure adequate funding. Poor countries can experiment with simple models to reduce severity of poverty, combined with other programs. Administrative requirements should be kept low.
Energy subsidies	Use declining but still popular; programs primarily benefit urban middle class.	Phase out in favor of means-tested assistance.
Food subsidies	Used initially during liberalization	Not recommended because difficult to target.
Food rations or food stamps	Not used, except in conflict situations.	Might be useful in low-income countries in urban poverty situations, especially where alcoholism is present. Education system could be used as delivery mechanism.
Housing subsidies	Not widely used as most housing is owner-occupied. Used for municipally-owned housing in areas where privatization has not taken place.	In current use, not well targeted and should be discontinued except possibly for special cases (e.g., poor single pensioners over 70). May become important in the future as part of a package to encourage labor mobility.
School feeding programs	Not widely used.	Recommend trials to support community-based interventions for children and to improve attendance of excluded groups.
School fee waivers or free textbooks, materials	Not widely used, in part because explicit fees are rare and out-of-pocket costs for parents are generally low (but significant for the poor).	Recommend trials to support community-based interventions for children and to improve attendance of excluded groups.
Health fee waivers	Often provided for pensioners and children, but under-the-table payments not covered.	Means-tested waivers could be tested in middle-income countries, for a selected package of services. Poor countries should reduce costs of a key health package.
Labor-intensive public works programs for unemployed including food for work	Not used, in part because of association with planned economy and/or forced labor camps.	Recommend trials as part of regional development programs for depressed areas.
Institutional care	Improperly used in cases of family poverty (especially single parent) or a vulnerable individual needing special care.	Develop alternatives to support families in the community and discontinue use.

- *Means testing*: Recent improvements in the design and administration of means-tested cash transfers to households in a number of the richer countries suggest that increased use of this strategy is a feasible option, at least for the middle-income countries. An upward ceiling on the income of households eligible for categorical benefits such as child allowances should also be considered in countries where this is not in place.[26] It should be noted that, even with improvements, significant leakage should be expected, given the relatively flat income distribution and the problems of transient poverty, which is exacerbated by low savings.

- *Energy subsidies* and other in-kind subsidies should be phased out, as these are not well targeted.
- Wider use of *targeted subsidies for social services* and school feeding programs may be justified, especially in low-income countries, where fees (formal and informal) are blocking access and exacerbating poverty.
- All countries should develop a reform program to reduce reliance on *wasteful institutional care.*

In general, countries should consider trying to move resources out of social insurance programs by tightening eligibility, and moving the funds into two areas—means-tested programs and overall social service delivery. Social insurance programs as currently structured have reduced labor supply of the working-age population at a high cost (e.g., pension systems). Especially in low-income countries, more funding for other social services could improve access for the poor and reduce vulnerability. For example, expenditures could be shifted into programs to reduce the risk of poverty posed by high health expenditures or improve access to education. This is not the most targeted resource re-allocation (most incidence studies would find the benefits accrue to middle-income groups), but since these social services are used more intensively by dependents (the old and the young), this approach would favor households with more dependents, who do tend to be poor. Some pro-poor elements should be included (sliding fee scales, etc.). Of course, parallel efforts need to be made to improve the quality and cost-efficiency of these primarily publicly-provided services (including increased use of non-governmental contractors).

Adequate financing for safety net programs is key. Purely local financing of safety net programs seems to ensure poor targeting, as the poorest areas do not have adequate funds. Better results seem to be registered when national financing (ring-fenced or earmarked) is combined with local community administration. However, this result is not strongly robust.[27] It clearly depends on the accountability structures of local administrators and their marginal propensity to spend on the poor. Neglect and exclusion of ethnic minorities is a common problem, which can only be countered by national monitoring. Given the transient nature of poverty, flexibility in program design and regular re-certification of eligibility is also important. Countries with extreme fiscal decentralization could consider a partial national financing (matching requirements), but this approach will continue to favor richer areas.

Regional pockets of poverty may benefit from increased use of employment generation programs such as labor-intensive public works, especially if used in combination with back-to-work incentives in other safety net and insurance programs.

[26] Note that child allowances also have an income smoothing function between child-rearing and non-child-rearing years, and are partial compensation for the social costs of child rearing. Therefore, the case for limiting this benefit to the very poorest households is weaker, but the case for imposing an upper ceiling on the income of recipients of perhaps half the median per capita household income is stronger. See Holzmann and Jorgensen (1999).

[27] See Klugman (1997) for framework and evaluation of decentralization of programs for children.

In the lowest-income countries, national means-tested cash benefit programs may not be feasible owing to cost and weak administrative capacity. However, countries can take steps to simplify cash benefit systems and improve the targeting of existing child allowance programs, for example. National resources provided for local programs that support economic growth (e.g., social fund-type programs) or provide community-based services to residents may increase the effectiveness of the safety net. In these countries, scarce public resources need to be spent on investment, including insuring access to education and effective health care.[28]

Donors should continue to support the institutional development of the social assistance service system. This includes training in social work and in program evaluation. It also includes attention to the sociological and psychological costs of the transition (including breakdown of social capital) and the effects on families, especially children at risk.

Monitoring program outcomes and evaluating impact is always important, but it is even more important when developing new approaches in transition economies. The recent improvements cited above came in part as a result of previous analyses showing program ineffectiveness. Transition economies should include monitoring plans, using household survey data, in their poverty alleviation strategies.

As we argued above, the transition was quite *sui generis*. However, one important lesson does emerge which may be of help for other countries as well as the remaining transition economies. When reacting to a social and economic shock as strong as the transition, it may be less risky to try to develop strategies based on existing institutions and laws, even if these are second or third best. It takes time to develop new, effective social institutions—both in terms of developing an administrative culture that supports such an institution and in terms of public support. Institutions imported from other cultures need to be adapted in any case. In order for this adaptation to be effective, the objectives have to be clear and well supported.

[28] See Smith and Subbarao (2001) for a discussion of safety nets in situations of mass poverty.

Annex 1: Summary of Recent Country-Level Analyses on Poverty and the Effectiveness of Safety Nets

Note: This table is drawn from individual World Bank country analyses, various years. The poverty lines are not comparable across countries, nor are the evaluations. The data are presented purely to give a quick snapshot collage of the region, and an indication of the richness of country-level analysis.

Country	*Findings on poverty (latest estimate)*	*Evaluation of Safety Nets*
Albania	Poor 30 percent rural, 15 percent urban, have more children, are self-employed (not wage earners), are older, have less education.	Social assistance spending 1.6 percent of GDP; use of means testing plus community targeting resulted in over 50 percent of lowest-income decile getting benefits; percentage getting benefits falls as income increases. Allegations of corruption at local level.
Armenia	Poor: 55 percent Extreme poverty: 28 percent Urban population poorer, but higher extreme poverty in rural areas; working households with children poor; high income inequality.	Social assistance (Paros system): 54 percent goes to the poorest 40 percent
Azerbaijan		45 percent of payments untargeted
Bulgaria	Poor: 12.8 percent Poverty gap: 4.2 percent Roma: 62 percent poor	31 percent of households receiving means-tested social assistance are poor, but these households received 53 percent of total expenditures.
Estonia	Poor: 15.5 percent	12.3 percent of poor households get targeted social assistance
Georgia	11.1 percent poor; 12.9 percent urban, 9.9 percent rural	
Hungary	Poor: 21 percent Rural poverty 24 percent Poverty gap : 14 percent (Braithwaite, Grootaert, and Milanovic 2000) Long-term poverty 7.5 percent; correlates of long-term poverty: rural, unemployment, children, single parent, single female pensioner, low education, Roma ethnicity (World Bank 2001b).	24 percent of households receive some social assistance. 43 percent of poor receive, 23 percent of non-poor receive. Leakage: 87 percent.
Kazakhstan	Poor: 35 percent, have more children, are unemployed; high regional concentration of poverty in the south	Social assistance spending fell from 1.4 percent of GDP in 1992 to 0.3 percent in 1997; only 36 percent of poor households get social assistance; compared with 25 percent of non-poor. Other benefits and privileges reach primarily non-poor.
Kosovo	Poor: 50 percent Poverty gap: 15.7 percent Extreme poverty: 12 percent	Food aid: 20 percent of consumption of poorest quintile, 2 percent for richest

Kyrgyz Republic	Head count of poor: 64 percent Poverty gap: 25 percent Urban poverty: 49 percent	Social assistance: 4 percent of income of poorest decile, 2.7 percent of income of richest decile; importance declined since 1993. Only a small percent of households receive assistance; utility subsidies mostly benefit non-poor.
Latvia	Poor: 18 percent Rural poor: 27 percent Poverty gap: 4.9 percent	15 percent of social assistance received by lowest decile; leakage = 75 percent
Moldova	Poor: 23.3 percent Rural poor: 27 percent 2+ children more likely to be poor	Complex set of benefits poorly targeted
Poland	Poor 23 percent Rural poor: 34 percent Poor are rural, have large numbers of dependents, and younger, but if older families fall into poverty, they do not come out very easily.	3.7 percent receive social assistance; 64 percent of those receiving social assistance were poor; 35 percent were non-poor. Social assistance was 22 percent of expenditures of the poor, 17 percent of non-poor (Braithwaite, Grootaert, and Milanovic 2000). Social assistance was 25 percent of income of chronically poor, 5 percent of non-poor (Okrasa 1999)
Russian Federation	Poor: 43.1 percent Extremely poor: 15 percent Extremely poor relative risk: rural 1.2 small and medium urban: 1, major city: 0.5.	13 percent received social assistance; 63 percent of non-poor get social assistance.
Ukraine	Poor: 27 percent Extreme poor: 13.5 percent Poor tend to be less educated.	Spending on social assistance: 3 percent of GDP; 42 percent of families get some transfers, upper income get more. Over half of families with young children did not receive family allowances. Transfers reduced poverty by 3.5 percent.
Uzbekistan		Mahalla community targeted scheme reaches 27 percent of poor households, but 40 percent of benefits go to top 60 percent. Size of benefit poorly related to need.

Source: See References. Where there are several sources, the reference is in the table.

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9934	Helping the Poor Manage Risk Better: The Role of Social Funds by Steen Jørgensen and Julie Van Domelen
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9932	Poverty and Disability: A Survey of the Literature by Ann Elwan
9931	Uncertainty About Children's Survival and Fertility: A Test Using Indian Microdata by Vincenzo Atella and Furio Camillo Rosati
9930	Beneficiary Assessment Manual for Social Funds by Lawrence F. Salmen

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No.	Title
9904	Social Protection as Social Risk Management: Conceptual Underpinnings for the Social Protection Sector Strategy Paper by Robert Holzmann and Steen Jorgensen (available in Russian)
9903	A Bundle of Joy or an Expensive Luxury: A Comparative Analysis of the Economic Environment for Family Formation in Western Europe by Pierella Paci
9902	World Bank Lending for Labor Markets: 1991 to 1998 by Amit Dar and Zafiris Tzannatos
9901	Active Labor Market Programs: A Review of the Evidence from Evaluations by Amit Dar and Zafiris Tzannatos
9818	Child Labor and School Enrollment in Thailand in the 1990s By Zafiris Tzannatos
9817	Supervising Mandatory Funded Pension Systems: Issues and Challenges by Gustavo Demarco and Rafael Rofman
9816	Getting an Earful: A Review of Beneficiary Assessments of Social Funds by Daniel Owen and Julie Van Domelen
~~9815~~	This paper has been revised, see Discussion Paper No. 9923
9814	Family Allowances by Suzanne Roddis and Zafiris Tzannatos
9813	Unemployment Benefits by Zafiris Tzannatos and Suzanne Roddis
9812	The Role of Choice in the Transition to a Funded Pension System by Robert Palacios and Edward Whitehouse
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9809	Financing the Transition to Multipillar by Robert Holzmann

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Summary Findings

This paper focuses on the experience of the transition countries of Central and Eastern Europe and Central Asia in providing adequate safety nets for the poor during the last 10 years. The paper discusses the problem of poverty and vulnerability — who were the poor, and how did the answer to this question change over the decade, it looks at the typical types of interventions offered by governments, and how this package changed over the period. It surveys the evidence on effectiveness of these programs in reaching the poor, in reducing their income poverty, or reducing other aspects of poverty (e.g. social exclusion). The results are quite striking, as in all countries, classic targeted safety net policies played a small role in reducing poverty. In part, this was because of the uniqueness of the period — conventional good practice was not always applicable.

Recently, several countries in the region have improved the coverage and targeting of their programs, offer good models for other countries. If all middle income countries in the region adopted these models, including insuring adequate financing, effective poverty reduction at low cost is possible. Financing for this benefit could come from reducing expenditures on untargeted categorical benefits and energy subsidies. Low income countries may find that implementing a full means-tested cash benefit system is too costly and administratively complex, although it should be noted that Armenia and Albania have both implemented programs successfully. These countries may wish to try less complex solutions such as distributing food rations through schools or school feeding programs. Fee waivers or subsidies to improve access to social services for the poor could also be helpful.

About this series...

The World Bank Social Safety Nets Primer is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking of specialists and practitioners on the role of social safety nets in the broader development agenda. Primer papers are designed to reflect a high standard of quality as well as a degree of consensus among the World Bank safety nets team and general practitioners on good practice and policy. Primer topics are initially reviewed by a steering committee composed of both World Bank and outside specialists, and draft papers are subject to peer review for quality control. Yet the format of the series is flexible enough to reflect important developments in the field in a timely fashion.

The primer series contributes to the teaching materials covered in the annual Social Safety Nets course offered in Washington, DC, as well as various other Bank-sponsored courses. The Social Safety Nets Primer and the annual course are jointly supported by the Social Protection unit of the Human Development Network and by the World Bank Institute. The World Bank Institute also offers customized regional courses through Distance Learning on a regular basis.

For more information on the primer paper series and papers on other safety nets topics, please contact the Social Protection Advisory Service; telephone (202) 458-5267; fax (202) 614-0471; email: socialprotection@worldbank.org. Copies of related safety nets papers, including the Social Safety Nets Primer series, are available in electronic form at www.worldbank.org/safetynets. The website also contains translated versions of the papers as they become available. An ambitious translation plan is underway (especially for Spanish and French, some in Russian). For more information about WBI courses on social safety nets, please visit the website www.worldbank.org/wbi/socialsafetynets.